



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
AMERICAN A-ONE INVESTMENT COMPANY }

Appearances!

For Appellant: Philip Crittenden, Attorney at Law
For Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate
Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of American A-One Investment Company to a proposed assessment of additional franchise tax in the amount of \$2,082.34 for the income year ended June 30, 1949.

On March 1, 1945, George D. Latham and Ruth E. Latham, husband and wife, purchased the Park Boulevard Hotel in San Diego, California. About September 1, 1946, they incorporated Appellant and transferred to it the hotel building, in exchange for all of Appellant's authorized shares, At the same time the Lathams leased to Appellant the underlying land at a monthly rental of \$450. Appellant operated the hotel property under this arrangement until August, 1948,

On or about August 19, 1948, the hotel improvements and land were sold to Dudley P. and Leona B. Peugh for a price of \$130,000. To effect the transfer Appellant executed a quit-claim deed to the Lathams and they in turn executed a grant deed to the Peughs. The purchase price was paid by the Peughs with an equity valued at \$5,000 in a motel and their promissory note in the amount of \$125,000, secured by a deed of trust on the hotel property in favor of Appellant, The Lathams and Appellant apportioned \$10,000 of the sales price to the land and \$120,000 to the improvements, To carry out this division of the proceeds of sale the Lathams retained the equity in the motel and Appellant took the note for \$125,000, at the same time setting up in its books a credit to the Lathams in the amount of \$5,000.

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After making monthly payments of principal and interest to Appellant in the aggregate amount of \$4,000, the Peughs defaulted on their note. In the meantime Appellant had secured a bank loan of \$30,000 and had pledged the deed of trust on the hotel as security.

At some time prior to April 11, 1949, the Lathams had purchased a second deed of trust on the hotel which had been given by the Peughs to certain real estate agents to secure payment of \$1,000 of their commission. On that date, the Lathams commenced foreclosure proceedings on the second deed of trust. On April 15, 1949, the Peughs commenced an action against Appellant and the Lathams to rescind the sale of the hotel on the grounds of fraud and misrepresentation. On April 27, 1949, the Peughs and Lathams entered into a written agreement to rescind the sale,

The agreement provided that the Lathams were to pay to the Peughs the sum of \$2,500 and assume the two trust deeds. The Peughs were to reconvey the hotel property to the Lathams by a grant deed. The suits filed by the several parties to the agreement were to be dismissed. Although not mentioned in the agreement, the equity in a motel, acquired by the Lathams as part of the consideration for the sale of the hotel property, was also returned to the Peughs. The agreement stated that "this agreement rescinds transfer of said hotel,"

Performance of the terms of the agreement was completed on June 2, 1949. The \$2,500 payment required by the agreement was made by Appellant to the Peughs and they in turn transferred title to the hotel property to the Lathams. Immediately after the reconveyance Appellant made entries in its books to reverse the entries made at the time of sale, except that the amount of \$1,733, received on the principal of the purchase note, was credited to surplus. As the result of these changes the note secured by the trust deed was dropped from Appellant's accounts and it again carried the hotel improvements in its books at the same value at which they were carried prior to the sale,

Appellant resumed operation of the hotel and again paid to the Lathams a ground rental of \$450. per month. Appellant paid off its loan from the bank on April 6, 1951, and the deed of trust, which had been pledged as security, was returned to it. The Lathams then transferred title to the hotel improvements to Appellant and the deed of trust was cancelled. At no time between the date of sale in 1948 and April 6, 1951, did the Lathams carry the Park Boulevard Hotel improvements as an asset on their books. They did not show the obligation secured by the trust deed in their accounts and they made no

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payments of principal or interest to Appellant,

Although it retained only \$1,500 of the payments made by the Peughs, Appellant reported a gain on the transaction in question in the amount of \$1,733.35, representing payments received on the principal amount of the note. The Franchise Tax Board determined that Appellant realized a taxable gain of \$66,775.31, this sum being the difference between its share of the sales price and its basis for the hotel improvements.

The Franchise Tax Board asserts (1) that where a sale and reacquisition of property occur in different taxable years they constitute separate transactions for tax purposes and (2) that even where the sale and reacquisition occur in the same taxable year, they must be considered as separate transactions if the parties are not placed in status quo by the reacquisition. Appellant does not disagree with these assertions or the decisions cited by the Franchise Tax Board in support thereof, although it points out that none of the decisions relied on by the Franchise Tax Board deals with rescission. Appellant does, however, contend that it was restored to status quo within the taxable year in which the sale occurred.

The sole argument of the Franchise Tax Board appears to be that during the year of the sale Appellant did not recover what it had sold. The evidence before us, however, leaves no doubt as to the ownership of the hotel improvements following rescission of the sale. It is apparent that as respects the hotel improvements, the Lathams were acting for and on behalf of the Appellant throughout the entire transaction. They were mere conduits of title and neither claimed nor exercised any rights of ownership in derogation of Appellant's title. Under these circumstances, the retention by the Lathams, for the convenience of Appellant, of the bare legal title beyond the year in which the sale occurred is of no significance for tax purposes.

As our courts have frequently stated, "taxation is not so much concerned with the refinements of title as it is with actual command over the property.." Corliss v. Bowers, 281 U.S. 376; Griffith v. Helvering, 308 U.S. 355. Here command of the property by Appellant following rescission of the sale is adequately established by its prior ownership of the property, its return of \$2,500 to the Peughs, the books of Appellant and the Lathams, the absence of any payments on the purchase note by the Lathams and the resumption by Appellant of the operation of the hotel under the prior ground rental agreement.

Although under the agreement Appellant was allowed to retain \$1,500 of the payments received from the Peughs, it does not follow that the parties were for that reason not

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placed in status quo, or that the sale was not extinguished by the rescission, To the contrary, upon rescission of a sale, the return of the consideration received by the seller requires the buyer to account for the value of the use of the property while it is in his possession, Heintzsch v. La France, 3 Cal. 2d 180, Since \$1,500 did not **exceed** the reasonable rental value of the hotel property while it was in the possession of the Peughs, this amount is properly attributed by Appellant to the use of the property by the Peughs, During the year in question it derived no gain from a sale of the property,

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of American A-One Investment Company to a proposed assessment of additional franchise tax in the amount of \$2,082.34 for the income year ended June 30, 1949, be and the same is hereby reversed.

Done at Sacramento, California, this 27th day of November, 1956, by the State Board of Equalization,

Paul R. Leake _____, Chairman

Robert E. McDavid _____, Member

James H. Quinn _____, Member

Geo. R. Reilly _____, Member

Robert C. Kirkwood _____, Member

ATTEST: Dixwell L. Pierce _____, Secretary